

# **REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MIER LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Mier Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) issued by the Accounting Standards Board and in accordance with the requirements of section 122(3) of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on conducting my audit in accordance with the International Standards on Auditing and *General Notice 111 of 2010 issued in Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Cash and cash equivalents**

4. I could not obtain reasonable assurance on the completeness, existence, valuation and allocation as well as rights and obligations pertaining to cash and cash equivalents disclosed in note 1 to the statement of financial position as R2 820 375 (2010: R30 011). The municipality's systems and records did not permit the application of alternative audit procedures.
5. SA Standards of GRAP 1 *Presentation of Financial Statements* defines cash and cash equivalents as a financial asset and states that a financial asset should be carried at fair value. Cash and cash equivalents were misstated due to the following:
  - Value-added tax (VAT) of R133 584 was incorrectly classified and offset against the overdraft of cash and cash equivalents.
  - An outstanding deposit was recorded twice on the bank reconciliation.
  - Prior period errors were not corrected in the current year.

#### **Receivables from exchange transactions**

6. I could not obtain reasonable assurance on the valuation and allocation, existence, completeness and rights pertaining to trade receivables from exchange transactions disclosed in note 2 in the statement of financial position as R2 223 881 (2010: R6 906 797) due to the matters listed below. The municipality's systems and records did not permit the application of alternative audit procedures.
  - The amount disclosed in the annual financial statements and the general ledger differed by R7 647 019 and I was unable to obtain sufficient appropriate audit evidence for this amount.
  - I could not obtain sufficient appropriate audit evidence for receivables from exchange transactions of R1 202 386.
  - I was unable to obtain sufficient appropriate audit evidence for journals processed of R8 539 389 relating to the compilation of the financial statements.
  - I was unable to confirm the existence of receivables of R394 295.
7. Paragraphs 43 and 46 of International Accounting Standard (IAS) 39 *Financial Instruments: Recognition and Measurement* state that receivables have to be initially measured at fair value and subsequently measured at amortised cost using the effective interest method. Receivables from exchange transactions were misstated due to the following:
  - Indigent applicants were charged the normal rate instead of the indigent rate for services. This would result in an overstatement of revenue and receivables and the understatement of doubtful debts, as indigents will not be able to pay for service charges. I could not determine the amount of these misstatements.
  - No interest was charged on long-outstanding debtors, resulting in receivables from exchange transactions being understated. I could not determine the amount by which the receivables were understated, as no interest rate was included in the debt collection policy.
  - The municipality disclosed Rnil in note 2 to the financial statements as a receivable from government institutions, which was understated by R751 049 as the outstanding debt of government institutions was not disclosed.
  - The provision for doubtful debts for the prior year was understated by R6 016 985, as debtors were not assessed on the same basis as in the current year. This also resulted in the VAT receivable being overstated by R738 927.

#### **Other receivables from non-exchange transactions**

8. I could not obtain sufficient appropriate audit evidence for other receivables from non-exchange transactions disclosed as R169 310 in note 3 to the financial statements. The municipality's systems and records did not permit the application of alternative audit procedures. Consequently, I was unable to perform satisfactory audit procedures to obtain reasonable assurance on the valuation, allocation and existence as well as rights and obligations pertaining to other receivables from non-exchange transactions.

## **Inventory**

9. I could not obtain reasonable assurance on the completeness, existence, valuation and allocation as well as rights pertaining to inventory disclosed in note 5 as R563 759 (2010: Rnil) due to the matters listed below. The municipality's systems and records did not permit the application of alternative audit procedures.

- No inventory reconciliations were performed between the inventory on hand and the accounting records.
- I could not satisfy myself as to the existence, valuation and completeness of inventory, as an inventory count was not performed at year-end.
- I was unable to obtain sufficient appropriate audit evidence for a difference of R563 759 between the amount disclosed in the annual financial statements and the general ledger.

10. Paragraph 9 of SA Standards of GRAP 12 *Inventories* states that inventories encompass goods purchased and held for resale including land and other property held for sale and that inventories that qualify for recognition as assets shall initially be measured at cost. Inventory issued, predominantly meter readers, was not expensed when issued, resulting in inventory being overstated and expenditure being understated by R294 103.

## **Value-added tax**

11. I was unable to perform satisfactory audit procedures to obtain reasonable assurance on the existence, valuation and allocation, completeness as well as rights and obligations pertaining to the VAT receivable disclosed as R203 987 (2010: R511 030) in note 18 to the financial statements, as no VAT invoices were attached to payments of R142 045. The municipality's systems and records did not permit the application of alternative audit procedures.

12. IAS 39 *Financial Instruments: Recognition and Measurement* states that receivables are recognised as assets when the entity has a legal right to receive cash. The VAT receivable was misstated due to the following:

- Output VAT was incorrectly calculated at a rate of 14% and recorded on the financial system for grants received, which are zero-rated in terms of the Value-Added Tax Act of South Africa, 1991 (Act No. 89 of 1991). This resulted in the VAT receivable and government grants and subsidies being understated by R634 761.
- The VAT receivable was overstated, as invoices of R1 476 523 did not contain the VAT number of the municipality, resulting in an overstatement of the VAT receivable.
- The VAT receivable was further understated, as invoices of R51 245 were identified on which VAT had not been claimed.
- Differences of R26 698 for the VAT payable and R697 353 for the VAT receivable existed between the VAT 201 forms and the general ledger. This resulted in the VAT receivable being overstated by R670 655.

## **Property, plant and equipment**

13. I could not obtain reasonable assurance on the completeness, existence, valuation and allocation as well as rights and obligations pertaining to property, plant and equipment disclosed in the statement of financial position as R149 784 420 (2010: R148 871 405) due to the matters listed below. The municipality's systems and records did not permit the application of alternative audit procedures.

- I was unable to obtain sufficient appropriate audit evidence for additions of R42 502.
- I could not obtain sufficient appropriate audit evidence for the completeness of property, plant and equipment, as the municipality did not have a property register containing the property rates charged to consumers.
- As reported in the prior year an unexplained difference were found between the asset register and the financial statement of R11 368 594.
- The municipality did not perform an asset count at year-end and the fixed asset register was only updated at year-end.
- I was unable to obtain sufficient appropriate audit evidence for a difference between the amount disclosed in the annual financial statements and the general ledger of R913 015 for property, plant and equipment and R1 396 125 for depreciation. This difference related to journals that had been processed in the compilation of the financial statements.
- The objective of Directive 4 issued by the Accounting Standards Board is to set the transitional provisions for individual Standards of GRAP for medium- and low-capacity municipalities. Where an entity has taken advantage of the transitional provisions in other Standards of GRAP, the following disclosures shall be made in the financial statements:
  - The classes of assets and/or liabilities that have not been measured in accordance with the applicable Standards of GRAP at the previous reporting date, but which are now so recognised.
  - The nature and amount of any measurement period adjustments recognised during the period.
  - Information on the progress made by an entity towards measuring assets or liabilities in accordance with the requirements of Standards of GRAP and recognising major classes of assets and liabilities that have not been recognised in full.

I could not confirm the disclosure and presentation of Directive 4 and the impact thereof on the financial statements, as the entity did not have processes and procedures to apply the transitional provisions required by Directive 4.

14. SA Standards of GRAP 17 *Property, Plant and Equipment* states that subsequent to initial recognition at cost, an item of property, plant and equipment should be carried at cost less accumulated depreciation and accumulated impairment losses. Property, plant and equipment was misstated due to the following:

- Assets were identified that had not been included in the asset register at the market value, resulting in an understatement of R72 000.
- As reported in the prior year assets of R68 400 were disposed in the prior year were not recorded in the asset register and the financial statements.
- Property, plant and equipment was understated and general expenditure overstated by R21 406 due to assets that had been incorrectly classified as general expenditure.
- The asset register did not include all the property, plant and equipment items identified on the premises of the municipality.
- Assets of R110 600 were not in a working condition, resulting in property, plant and equipment being overstated.
- Assets were not revalued annually or their useful lives were not assessed according to the accounting policy, resulting in assets being misstated by an unquantifiable amount.

### **Investment property**

15. The municipality did not disclose investment property. The completeness of investment property could not be confirmed due to the municipality not having policies and procedures for the identification of investment property to be recorded in the property register. The municipality's systems and records did not permit the application of alternative audit procedures regarding the completeness of amounts that should have been disclosed as investment property.

### **Trade and other payables from exchange transactions**

16. I could not obtain reasonable assurance on the completeness, existence, valuation and allocation as well as obligations pertaining to trade and other payables from exchange transactions disclosed in note 16 as R2 402 348 (2010: R3 299 569). Furthermore, there was a difference between the financial statements and the general ledger of R2 015 452. There were no satisfactory alternative audit procedures that I could perform, as the municipality did not have a system and controls over trade and other payables from exchange transactions on which I could rely for the purpose of my audit.

17. Paragraph 43 of IAS 39 states that when a financial liability is recognised initially, an entity shall measure it at its fair value. Payables were misstated due to the following:

- Trade and other payables from exchange transactions were understated, as a payment due to SARS of R1 044 012 was not disclosed as a payable.
- The municipality did not accrue for invoices amounting to R181 319 (2010: 736 018). If these invoices had been accrued for, the effect would have been to reduce the surplus for the period by R181 319 (2010: R736 018) and the accumulated surplus by R181 319 (2010: R736 018) and to increase the accrued liability in the statement of financial position by R181 319 (2010: R736 018).
- As reported in the prior year payables was overstated by R137 678 due to the incorrect allocation of a journal.

### **Taxes and transfers**

18. I could not obtain reasonable assurance on the existence, valuation and allocation as well as rights and obligations pertaining to taxes and transfers disclosed as R1 018 010 (2010: Rnil). Furthermore, a difference between the financial statements and the general ledger of R108 728 was identified for which I could not obtain sufficient appropriate audit evidence. The municipality's systems and records did not permit the application of alternative audit procedures.

### **Provisions**

19. Provisions were disclosed as R504 510 in note 20 to the financial statements. I was unable to obtain sufficient appropriate audit evidence for journals of R385 185, which increased the provision. Consequently, I could not obtain reasonable assurance on the existence, valuation and allocation as well as the obligations pertaining to the provisions disclosed.

20. SA Standards of GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets* states that provisions are liabilities of uncertain timing or amount. SA Standards of GRAP 19 further states that 'accruals are a liability to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees'. Provisions were misstated due to the following:

- Provision has not been made for environmental rehabilitation costs to restore the entity's landfill sites. A provision should be made for the entity's present obligation incurred because of its past use of the landfill sites in accordance with SA Standards of GRAP 19. This resulted in the understatement of provisions and assets by an unquantifiable amount.
- Leave and bonuses were incorrectly disclosed as a provision, resulting in provisions being overstated by R504 510 and trade and other payables from exchange transactions being understated by R504 510. Furthermore, the provision for leave and bonus accrual was overstated by R111 723 (2010: R146 581) due to the application of incorrect formulas to calculate this accrual.
- The calculation on which the leave and bonus provision was based included terminated employees, resulting in the accrual amount being overstated by an unquantifiable amount.

#### **Unspent conditional grants and receipts**

21. I could not obtain reasonable assurance on the completeness, existence, valuation and allocation as well as rights and obligation pertaining to unspent conditional grants and receipts disclosed as R7 362 360 (2010: R2 646 340) in note 21, as no register could be provided for conditional grants received and expenditure incurred. Furthermore, there was a difference of R4 716 020 between the financial statements and the general ledger. The municipality's systems and records did not permit the application of alternative audit procedures.

#### **Long-term borrowings**

22. Borrowings were disclosed as R702 187 in note 22 to the financial statements. As I was unable to obtain sufficient appropriate audit evidence for a difference of R266 189 between the amount disclosed in the annual financial statements and the general ledger, I could not obtain reasonable assurance on the existence, valuation and allocation as well as the obligations pertaining to the long-term liabilities disclosed.

23. IAS 39 *Financial Instruments: Recognition and Measurement* states that payables are recognised as liabilities when the entity becomes a party to the contract and, as a consequence, has a legal obligation to pay cash. Long-term liabilities were overstated and current liabilities understated by R7 079, as the municipality did not correctly calculate the short-term portion of loans amounting to R7 079. Prior year errors were not corrected during the current year and retained earnings were therefore misstated.

#### **Finance leases**

24. SA Standards of GRAP 13 *Leases* states that a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership. In terms of SA Standards of GRAP 1 *Presentation of Financial Statements*, each material class of similar items shall be presented separately in the financial statements. The municipality did not disclose finance and operating leases of an unquantifiable amount, contrary to the accounting policy.

## **Funds and reserves**

25. Due to the impact of the limitation of scope on cash and cash equivalents, prior year uncorrected errors, revenue and expenditure, I could not obtain reasonable assurance on the valuation and allocation, existence as well as rights and obligations pertaining to the accumulated surplus disclosed in the statement of net assets as R143 376 484 (2010: R147 843 832). The municipality's systems and records did not permit the application of alternative audit procedures.

## **Joint venture**

26. The municipality did not disclose any joint ventures in the financial statements. A joint venture was entered into during prior periods, but no information concerning this arrangement was disclosed in the financial statements. The related revenue, expenditure, receivables or payables of the joint venture to which the municipality is entitled according to the agreement were not consolidated in the municipality's accounting records. I could not determine the impact on the financial statements.

## **Contingent liability**

27. Paragraph 110 of SA Standards of GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets* states that unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability. Contingent liabilities were understated by R190 000 as not all contingent liabilities were disclosed.

## **Commitments**

28. There was no contract management system for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments had been recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of Rnrl (2010: R5 798 807) as stated in note 52 to the financial statements.

## **Distribution losses**

29. Distribution losses for water were not disclosed, as required by section 125(2)(d)(i) of the MFMA. The losses were not quantified by the municipality.

## **Consumer deposits**

30. The municipality did not disclose consumer deposits of an unquantifiable amount, contrary to the accounting policy.

## **Revenue**

31. I could not obtain reasonable assurance on the completeness and accuracy of revenue disclosed in the statement of financial performance as R3 800 470 (2010: R3 084 530). The revenue amount consisted of property rates of R770 982 (2010: R712 417) and service charges of R3 029 488 (2010: R2 372 112) as disclosed in notes 26 and 27 to the financial statements, respectively, for which I could not obtain sufficient appropriate audit evidence.

32. Reconciliations of the differences between the water meter readings as per the system and the water meter reading forms were not performed. The municipality's systems and records did not permit the application of alternative audit procedures.

33. I was unable to obtain sufficient appropriate audit evidence for a difference of R2 316 956 between the amount disclosed in the annual financial statements and the general ledger relating to journals processed.

34. SA Standards of GRAP 9 *Revenue from Exchange Transactions* states that revenue shall be measured at the fair value of the consideration received or receivable. Revenue was misstated due to the following:

- Property rates were overstated by R615 383, as properties were identified in the valuation roll for which rates had not been charged or charged twice.
- Service charges were understated by R551 161 (overstated R26 608:2010), as incorrect tariffs were used to bill consumers for sewerage services.
- The sale of water was understated by R10 118, as water meter readings were incorrectly taken and recorded or certain water readings were not invoiced or incorrectly captured on SAMRAS.
- Revenue as disclosed in the statement of financial performance was misstated due to previous year errors of R292 131 that had not been corrected, as journals were incorrectly processed in the previous year.

35. SA Standards of GRAP 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* states that revenue comprises gross inflows of economic benefits or service potential received and receivable by an entity, which represent an increase in net assets, other than increases relating to contributions from owners. Government grants received were overstated by R540 736, as the Division of Revenue Act (DoRA) indicated an amount of Rnil. Furthermore, the VAT receivable was understated by R634 761, as output VAT was incorrectly claimed on these grants.

36. I could not obtain reasonable assurance on the completeness, accuracy as well as presentation and disclosure pertaining to other revenue for the rental of facilities and equipment and other income received as disclosed in note 32 and note 28 to the financial statements as R1 842 575 (2010: R397 879) and R454 922 (2010: R212 546), respectively, as sufficient appropriate audit evidence for other revenue disclosed could not be obtained. The entity's records did not permit the application of alternative audit procedures, as the municipality did not have a system for other rental income.

37. SA Standards of GRAP 9 *Revenue from Exchange Transactions* states that revenue shall be measured at the fair value of the consideration received or receivable. Other revenue for the rental of facilities and equipment and other income received were misstated due to the following:

- Other income was understated by R115 831, as incorrect tariffs were used to calculate hunting income and accommodation.
- Rental received for the rental of buildings was recorded in the incorrect accounting period, resulting in revenue for rental of facilities and equipment being overstated by R29 500.

- Revenue for the rental of facilities was understated by R40 314, as lease contracts were outdated or had expired, resulting in old tariffs being used.

38. In terms of SA Standards of GRAP 1 *Presentation of Financial Statements*, each material class of similar items shall be presented separately in the financial statements. Revenue from non-exchange transactions, revenue from exchange transactions and major classes of revenue were not disclosed separately as required.

#### **Expenditure**

39. I could not obtain reasonable assurance on the completeness, cut-off, accuracy, occurrence and classification of expenditure disclosed as R7 171 892 (2010: R4 666 448) in note 40 to the financial statements, due to the matters listed below. The municipality's systems and records did not permit the application of alternative audit procedures.

- I could not obtain sufficient appropriate audit evidence for expenditure transactions of R6 120 619 (2010: R4 266 638) relating to general expenditure.
- Sufficient appropriate supporting documentation could not be provided for expenditure recognised in the accounting records of R984 034.
- As there was no contract management for the identification and recognition of contracts, I could not determine the completeness of contracted services disclosed in note 38 to the financial statements as Rnil (2010: R594 799).
- I was unable to obtain sufficient appropriate audit evidence for journals processed of R443 636.
- Payments to suppliers for the maintenance of the accounting system were not done monthly. I could thus not satisfy myself as to the completeness of expenditure.

40. Paragraph 18 of SA Standards of GRAP 1 *Presentation of Financial Statements* states that the financial statements shall present fairly the financial performance of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for expenses. The following shortcomings were noted in this regard:

- Invoices pertaining to the 2009-10 financial year were recorded during the current financial period and paid in the 2011-12 financial year. Expenditure was understated in the 2009-10 financial period and overstated in the current financial year by R135 719. Trade payables were understated by R135 719 (R75 957:2010) for the current and the prior year.
- Bad debts were disclosed as R1 630 033 in the statement of financial performance. The total movement in the provision for bad debts amounted to R7 647 018, resulting in bad debts being understated by R6 016 985.
- Expenditure and payables were overstated due to differences between the invoice amount and the amount recorded on the financial system. This resulted in payables being overstated by R223 736.
- General expenditure was overstated by R21 406 and property, plant and equipment was understated, as expenditure relating to property, plant and equipment was incorrectly classified as current expenditure.

- Operating expenses and payables were understated by R181 319, as expenditure relating to the current year was not recorded in the accounting records.
- Prior period errors were not corrected.
- Repairs and maintenance were understated and wages overstated by R27 593, as repairs and maintenance were incorrectly classified as wages.
- Finance costs disclosed in note 36 as R208 066 (2010: R39 406) were understated by R130 836 (2010: R15 624), as finance costs were incorrectly classified as a long-term liability.

#### **Employee cost**

41. I could not obtain reasonable assurance on the completeness, accuracy, occurrence, disclosure or classification of employee cost disclosed in note 33 to the financial statements as R5 129 108 (2010: R5 803 561) and in the statement of financial performance due to the matters listed below. The municipality's systems and records did not permit the application of alternative audit procedures.

- No accounting policy was disclosed in the notes to the financial statements for the accounting treatment of employee-related cost.
- I was unable to obtain sufficient appropriate audit evidence for journals processed of R141 093.

42. Paragraph 18 of SA Standards of GRAP 1 *Presentation of Financial Statements* states that the financial statements shall present fairly the financial performance of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for expenses. Employee costs were understated by R47 511 as overtime paid was not disclosed.

#### **Unauthorised expenditure**

43. Section 125 of the MFMA requires the municipality to disclose unauthorised expenditure incurred. Unauthorised expenditure was understated by R584 368 (R119 351:2010) due to overspending on the waste management vote by R205 385 and the finance and admin vote by R378 983.

#### **Irregular expenditure**

44. I could not obtain reasonable assurance on the completeness of irregular expenditure disclosed as Rnil (2010: Rnil) in note 50.3 to the financial statements, as not all payments and tender documentation could be obtained. The municipality's systems and records did not permit the application of alternative audit procedures.

45. Section 112 of the MFMA requires the entity to implement and maintain an appropriate procurement and provisioning system that is fair, equitable, transparent, competitive and cost-effective. Payments amounting to R4 017 732 were made in contravention of the supply chain management (SCM) requirements. The amount was not included in irregular expenditure disclosed in note 50.3 to the financial statements, resulting in irregular expenditure being understated by R4 017 732 (2010: R2 529 670).

### **Fruitless and wasteful expenditure**

46. Section 125 of the MFMA requires the municipality to disclose fruitless expenditure incurred. Fruitless expenditure disclosed in note 50.1 to the financial statements was understated by R10 386, relating to interest incurred on long-outstanding creditor accounts.

### **Disclaimer of opinion**

47. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

### **Emphasis of matters**

48. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Financial reporting framework**

49. As disclosed in note 1 to the financial statements, the municipality prepared the financial statements on the going concern assumption in accordance with Generally Recognised Accounting Practice (GRAP).

50. As disclosed in accounting policy 2.1, the municipality is exempted from certain measurement requirements of GRAP as per Directive 4 of the Accounting Standards Board. The municipality did not comply with all of the disclosure requirements of this directive.

### **Funding of operations, financial sustainability and going concern**

51. The statement of financial performance indicated that the municipality incurred a net loss of R621 423 during the year ended 30 June 2011 and, as of that date, the entity's current liabilities exceeded its current assets by R5 705 749. These conditions indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to operate as a going concern.

52. While the municipality prepared financial statements on a going concern basis, there are a number of indicators that its financial sustainability is under threat. These include the following:

- Creditors and suppliers were not paid in time.
- The provision for bad debt increased to R12 003 495 (2010: R4 356 477).
- No payments were made during the year to SARS for VAT or PAYE/UIF/SDL.
- Borrowings were not repaid within time, resulting in penalties.
- The municipality had a disclosed bank overdraft of R133 584 (2010: R521 627).
- Capital funding for operations had to be paid back to the National Treasury, as the funding was not used during 2011.

53. The municipality is based in a remote area of the Northern Cape Province with little economic activity and many community members are classified as indigent. As a result, the municipality struggles to collect amounts owed to it by community members and this has resulted in cash-flow problems, which cast significant doubt on the municipality's ability to

continue as a going concern. The municipality is dependent on national and provincial government grants for its continued existence.

#### **Material losses and impairments**

54. As disclosed in note 2 to the financial statements, material losses of R12 003 495 were incurred as a result of an impairment of trade debtors.

#### **Material underspending of the budget**

55. As disclosed in appendix E1, the municipality materially underspent the budget for the executive council by R466 675 and for other expenditure by R2 117 045. As a consequence, the municipality did not achieve its service delivery objectives.

#### **Other matters**

56. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Unaudited supplementary schedules**

57. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

#### **Financial reporting framework**

58. The financial reporting framework prescribed by the National Treasury and applied by the municipality is a compliance framework. Thus, my opinion would have reflected that the financial statements had been properly prepared instead of fairly presented as required by section 20(2)(a) of the PAA, which requires me to express an opinion on the fair presentation of the financial statements of the municipality.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

59. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages xx to xx and material non-compliance with laws and regulations applicable to the municipality.

#### **Report on predetermined objectives**

60. I could not conduct an audit of performance against predetermined objectives, as the municipality did not prepare an annual performance report as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

#### **Compliance with laws and regulations**

##### **Strategic planning and performance management**

61. The municipal council did not, within the prescribed period after the start of its elected term, adopt a single, inclusive and strategic plan for the development of the municipality, as required by section 25 of the MSA.

62. The municipality did not enter into a service delivery agreement with another municipality for the provision of a municipal service, as required by section 76(b) of the MSA and Municipal

**Planning and Performance Management Regulation 9.**

63. The municipality did not implement a framework that described and represented how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement would be conducted, organised and managed, including determining the roles of the different role players, as required by sections 38, 39, 40 and 41 of the MSA and Municipal Planning and Performance Management Regulations 7 and 8.
64. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72(1)(a)(ii) of the MFMA.
65. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury and the provincial treasury, as required by section 72(1)(b) of the MFMA.

**Budgets**

66. The municipality incurred expenditure that had not been budgeted for and incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
67. The mayor did not submit all quarterly reports on the implementation of the budget and the financial state of affairs of the municipality to the council within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
68. The adjustment budget of the municipality was not approved by the council, as required by Municipal Budget and Reporting Regulation 25.
69. The accounting officer did not always submit the monthly budget statements to the mayor and/or the relevant provincial treasury, as required by section 71(1) of the MFMA.
70. Unforeseeable and unavoidable expenditure not provided for in the annual budget was incurred but was then not appropriated in an adjustment budget, as required by section 29(2)(d) of the MFMA.
71. The municipality did not make public the approved annual budget, supporting documents and accompanying resolutions within 10 working days after the municipal council had approved the annual budget, as required by section 24(3) of the MFMA.

**Annual financial statements, performance report and annual report**

72. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimed audit opinion.
73. The municipality did not prepare consolidated annual financial statements incorporating the annual financial statements of the municipality and of all municipal entities under the

municipality's sole or effective control, as required by section 122(2) of the MFMA.

74. Contrary to the requirements of section 126 of the MFMA, the annual financial statements were not submitted to the Auditor-General of South Africa for auditing within two months after the end of the financial year.
75. The mayor did not table the 2009-10 annual report of the municipality and of all municipal entities under its shared control in the council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
76. The mayor did not submit a written explanation to the council setting out the reasons for the delay in the tabling of the 2009-10 annual report in the council, as required by section 127(3) of the MFMA.
77. The performance report for the financial year under review was not prepared, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
78. The annual performance report did not contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan, as required by section 46 of the MSA.

#### Audit committee

79. No audit committee was in place as required by section 166 of the MFMA, and therefore:
  - The audit committee did not advise the council and the accounting officer of the municipality on matters relating to internal financial control and internal audit, risk management, accounting policies, performance management, effective governance, compliance with applicable legislation or performance evaluation.
  - The audit committee did not review the annual financial statements.
  - The audit committee did not respond to the council on any issues raised by the Auditor-General in the audit report.
  - The audit committee did not consist of at least three persons with appropriate experience.
  - The majority of the members of the audit committee were employees of the municipality.
  - The audit committee did not meet at least four times a year.
80. In the absence of an audit committee, the audit committee could not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
81. In the absence of an audit committee, the audit committee could not advise the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(a) of the MFMA.
82. No members of the audit committee were appointed by the council of the municipality, as required by section 166(5) of the MFMA.

83. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14.

84. The performance audit committee or another committee functioning as the performance audit committee did not perform the following, as required by Municipal Planning and Performance Management Regulation 14:

- Meet at least twice during the financial year.
- Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality.
- Review the municipality's performance management system and make recommendations in this regard to the council of the municipality.
- Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

**Internal audit**

85. No internal audit unit was in place as required by section 165(2) of the MFMA, and therefore:

- The internal audit unit did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
- The internal audit unit did not report to the audit committee on the implementation of the internal audit plan.
- The internal audit unit did not adequately advise the accounting officer and/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management as well as loss control.

86. In the absence of an internal audit unit, matters relating to compliance with the MFMA, DoRA and other applicable legislation were not reported to the audit committee, as required by section 165(2)(b) of the MFMA.

87. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14.

88. The internal audit processes and procedures did not include assessments of the functionality of the municipality's performance management system and whether the system complied with the requirements of the MSA, as required by Municipal Planning and Performance Management Regulation 14.

89. The internal audit processes and procedures did not include assessments of the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators, as required by Municipal Planning and Performance Management Regulation 14.

90. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and/or did not submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14.

#### **Procurement and contract management**

91. Goods and services with a transaction value between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as per the requirements of SCM Regulation 17(a) and (c).

92. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value between R10 000 and R200 000 had been procured by means of obtaining written price quotations from at least three different prospective providers, as per the requirements of SCM Regulation 17(a) and (c).

93. Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM Regulations 16(b) and 17(b).

94. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value above R200 000 had been procured by means of inviting competitive bids, as per the requirements of SCM Regulations 19(a) and 36(1).

95. Sufficient appropriate audit evidence could not be obtained that the preference point system had been applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and SCM Regulation 28(1)(a).

96. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM Regulation 14(1)(a).

97. Sufficient appropriate audit evidence could not be obtained that contracts or quotations to the value of R2 000 and more had been procured in accordance with legislative requirements and the SCM policy.

98. Sufficient appropriate audit evidence could not be obtained that bids had been evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as per the requirements of SCM Regulation 28(2).

99. Sufficient appropriate audit evidence could not be obtained that awards had been made to providers whose tax matters had been declared to be in order by SARS, as required by SCM Regulation 43.

100. Invitations for competitive bidding were not always advertised for the required minimum period, as per the requirements of SCM Regulation 22(1) and 22(2).

101. Awards were made to suppliers who did not submit a declaration on their employment by the state or their relationship to a person employed by the state, as per the requirements of SCM Regulation 13(c).

### **Expenditure management**

102. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
103. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
104. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that recognised expenditure when it was incurred, accounted for creditors of the municipality and accounted for payments made by the municipality, as required by section 65(2)(b) of the MFMA.
105. The accounting officer did not take reasonable steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
106. The municipality did not recover unauthorised, irregular as well as fruitless and wasteful expenditure from the liable person, as required by section 32(4) of the MFMA.

### **Human resource management**

107. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review, as required by section 57(1)(b) and 57(2)(a) of the MSA.
108. The municipal manager did not sign an annual performance agreement for the year under review, as required by section 57(1)(b) and 57(2)(a) of the MSA.

### **Revenue management**

109. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
110. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.
111. A credit control and debt collection policy was not maintained or properly implemented, as required by section 96(b) of the MSA.
112. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that recognised revenue when it was earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.

### **Asset management**

113. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that accounted for the assets of the municipality, as required by section 63(2)(a) of the MFMA.
114. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an updated asset register), as required by section 63(2)(c) of the MFMA.

### **INTERNAL CONTROL**

115. In terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

116. The management philosophy and operating style did not promote effective control over reporting. The chief financial officer position was vacant for the year, resulting in consultants having to be appointed to compile the financial statements.
117. Management did not provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the interests of the entity, as they did not keep proper record of payments and employee-related documentation.
118. Management did not establish and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities, as they did not circulate policies to all personnel, SCM policies were not adhered to and personnel were not aware of what was expected of them.
119. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls, as he did not develop and monitor the implementation of action plans to address prior year weaknesses.

### **Financial and performance management**

120. The annual financial statements were submitted for auditing four months late, as weekly and monthly reconciliations were not performed and suspense accounts were not cleared regularly.
121. Management and staff did not fulfil their duties and responsibilities, as requested information was not available or sometimes supplied after significant delays.
122. The accounting officer did not implement a system to ensure reviewing and monitoring of compliance with laws and regulations as well as internal control.

123. Pertinent information on revenue, receivables, expenditure, payables and employee costs was not identified and captured in a form and time frame to support financial and performance reporting.
124. The accounting officer did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
125. Management did not implement controls over daily and monthly processing and reconciling of transactions, as reconciliations could not be provided for creditors.
126. The accounting officer did not ensure the effective design and implementation of formal controls over information technology systems to ensure the reliability of the systems and the availability, accuracy and protection of information, as the balances reported in the financial statements did not tie up with the accounting system used.
127. The accounting officer did not exercise oversight responsibility to ensure that relevant performance objectives were set, information supporting the annual performance report was maintained and an annual performance report was submitted in a timely manner.

#### Governance

128. The municipality did not have an internal audit unit during the year.
129. The audit committee did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice, as there was no audit committee during the year.

*Auditor-General*

Kimberley

29 February 2012



Auditing to build public confidence